

COMPANIES MENTIONED

Fastenal
FAST - \$42.70 - Hold

W.W. Grainger
GWW - \$229.29 - Hold

MSC Industrial Direct
MSM - \$80.94 - Buy

BB&TCM Fastener Distributor Index: 2014 Starts Where 2013 Left Off - Slowly

KEY TAKEAWAY

The FDI in January 2014 picked up where 2013 left off: a reading of 51.5; the figure through 2013 was 51.2. Thus, the FDI continues to flash that demand is growing but slowly. We believe this had support in Q4'13 earnings reports and 2014 guidance. The consensus was still that industrial/non-residential demand, had improved, but glacially. There was no sense of acceleration. Conditions are okay. The outlook is decent. Distributors should not expect much different just yet.

KEY POINTS

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of NorAm fastener distributors, conducted with the **FCH Sourcing Network**. It offers insights into current trends/outlooks. As a diffusion index, figures above 50 signal strength and below 50 signal weakness. It should be directly relevant to **Fastenal** and broadly relevant to other distributors (**W.W. Grainger**, **MSC Industrial**).

We have begun seasonalizing the data. In the past, we provided a raw number. But that shows signs of seasonal influence, i.e., January is always strong coming off the holiday-impacted weaker December. This bias can be adjusted out. It will be refined as more data is available. In the interim, in the attached table we will show the raw and adjusted numbers, but in this text we will refer to the seasonally adjusted.

January FDI: More of the same. January came in at 51.5, largely unchanged from December (52.0). This is consistent with data over the last year: in H1'12, the FDI ranged from 48-51 (average 50); in H2'13 it ranged from 50-54 (average 52.5). So the start of 2014 looks a lot like most of 2014: an environment of slow growth. Most of the data is favorable: **Employment** (55.4) remains moderately positive, **Supplier Deliveries** (63.5) are still slowing, and **Customer Inventories** (40.5) are still seen as being too low. *The environment is unchanged: there is growth, but it is slow. This actually has support in two other data points. First, the PMI, which had been much stronger than the FDI over the preceding six months, fell back to 51.3 in January. Second, coming out of earnings season for Q4'13, the consensus remains that demand is on the mend, but very gradually. That sums up the FDI in January.*

Outlook: Still good, with a red flag. There remains little fear: 54% of respondents say conditions will improve in six months. That compares to just 11% that expect worsening. However, the percent of negative responses has not been higher since August 2013, so that is a bit of a change. *Nothing to worry about here, as a 5:1 ratio of positive to negative responses is solid. Still, upcoming survey will have to watch to see if the January spike in negative responses is noise or a trend.*

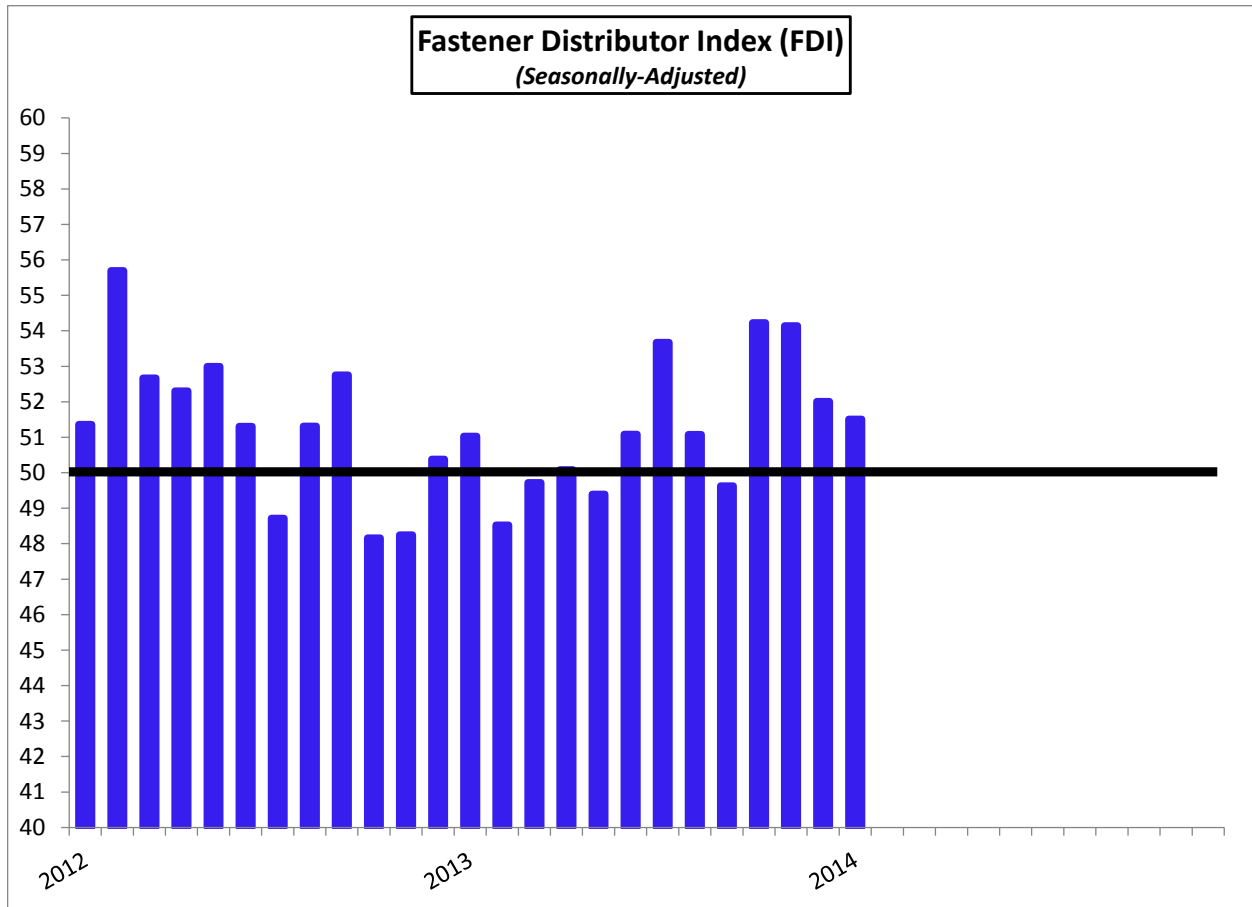
Price: the good news metric. In January, sequential price changes (62.2) occurred more aggressively than we have seen in the survey. We also note reported annual pricing was 2.0%-2.5%, up from 1.5%-2.0% in December. *Price was an issue in 2013. This may suggest distributors are finding space to lift prices to start the year.*

Survey Question: What impact Brighton Best? There are signs of rising prices in the wake of Brighton-Best buying Porteus. Indeed, 46% of respondents have seen no change in price, but 41% have seen prices rise (and one third of those are seeing product tightness). Still, ~80% of respondents will still source from masters, likely reflecting limited options in the master channel (20% will try to go direct). 49% of respondents expect the master channel to stabilize. 48% expect more consolidation sooner or later. *This may be an opportunity for Fastenal. It sources less product from masters due to more far-flung sourcing operations. If smaller competitors have to pay more for "B" and "C" class fasteners because of their dependence on masters while Fastenal does not, it could contribute to share gains.*

FASTENER DISTRIBUTION AT A GLANCE										
January 2014										
	----- Index Values -----							Dec.-->Jan.		
	Jan.	Dec.	Nov.	Oct.	Sep.	Aug.	July	Change	Direction	
PMI (Manufacturing Sector)	51.3	56.5	57.0	56.6	56.0	56.3	54.9	(5.2)	Growing	
MBI (Metalworking sector)	54.2	49.9	50.3	50.7	48.1	44.6	48.5	4.3	Growing	
FDI (Fastener Sector)	57.4	50.0	51.7	52.7	45.4	50.8	49.7	7.4	Growing	
FDI (Seasonally Adjusted)	51.5	52.0	54.1	54.2	49.6	51.1	53.7	(0.5)	Growing	
Sales	70.3	50.0	43.1	73.2	42.9	58.1	58.3	20.3	Growing	
Employment	55.4	53.6	56.9	53.6	50.0	50.0	51.4	1.8	Growing	
Supplier Deliveries	63.5	53.6	65.5	44.6	52.9	59.7	56.9	9.9	Slowing	
Respondent Inventories	55.4	57.1	65.5	55.4	62.9	66.1	62.5	(1.7)	Too High	
Customer Inventories	40.5	42.9	41.4	39.3	35.7	35.5	31.9	(2.3)	Too Low	
Pricing, month-to-month	62.2	50.0	58.6	55.4	54.3	56.5	52.8	12.2	Higher	
Pricing, year-to-year	67.6	71.4	65.5	62.5	62.9	62.9	55.6	(3.9)	Higher	
	<u>Higher</u>	<u>Same</u>	<u>Lower</u>							
6-Month Outlook - Dec.	54%	35%	11%							

FDI and Pricing are diffusion indexes. At 50, the performance of the category listed met expectations. A reading above 50 suggests the category outperformed expectations, while a reading below 50 suggests the category underperformed expectations.

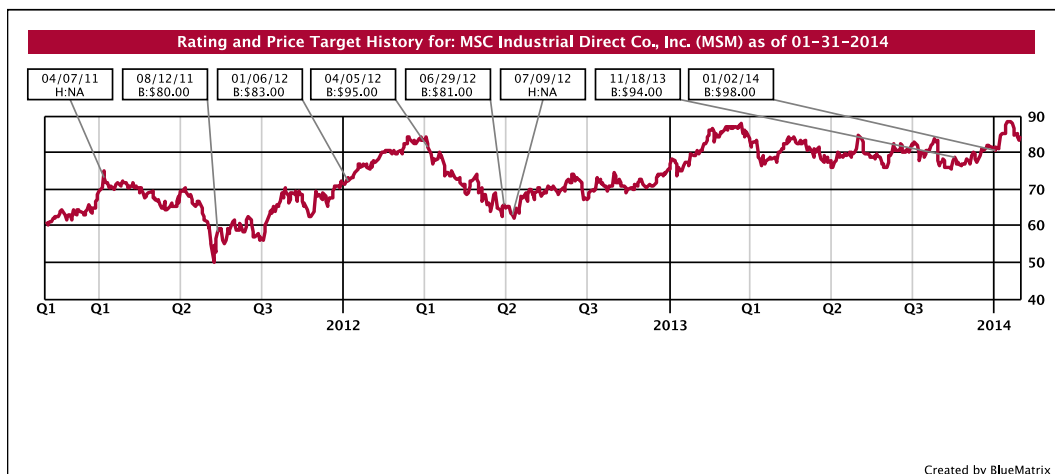
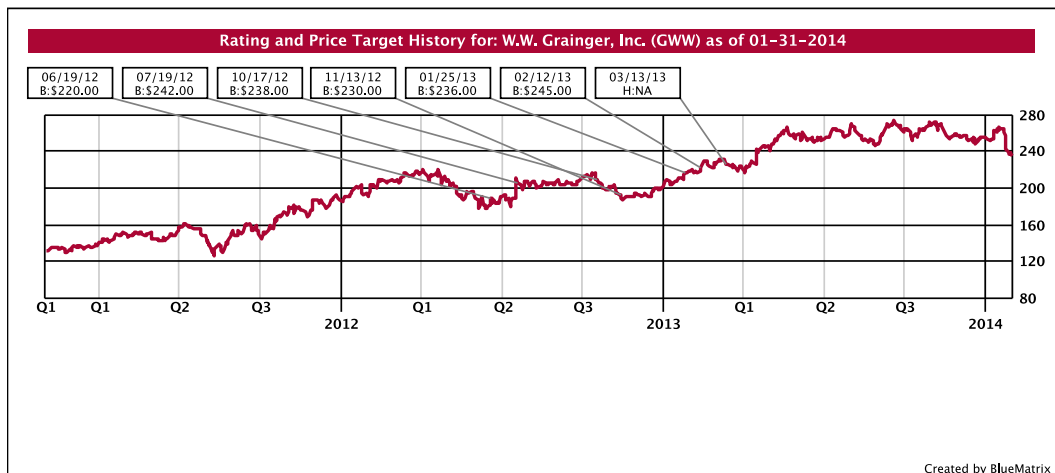
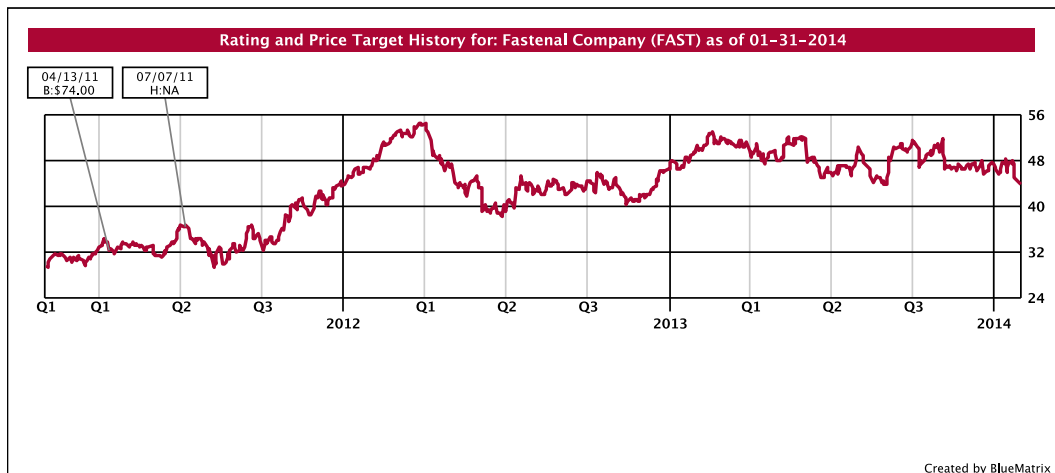
Sources: BB&T Capital Markets' estimates, FCH Sourcing Network, Institute for Supply Management



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Price Chart



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Underweight/Sell (3)	1.24%	Underweight/Sell (3)	0.00%
Not Rated (NR)	0.00%	Not Rated (NR)	0.00%

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